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ROMANIA'S FINANCIAL SITUATION AND OUTLOOK FOR 1983

Romania may be one of the first countries to recover from the debt crisis. While Bucharest has had to reschedule its debts the past two years, it vows to resume payments on time next year. In the past year there has been a noticeable turnaround in Romania's approach to its financial problems. The strongest testimony to Bucharest's effort to solve its debt problem is the sacrifices Romania has made by slashing imports in order to earn a trade surplus to pay creditors. Moreover, Bucharest's debt maturity structure improves substantially beginning this year, and rescheduling of bank debt this year is progressing smoothly. The IMF continues to approve Romania's performance and has sanctioned further drawings under the 1981 Standby Arrangement. Despite the improvement in Bucharest's financial situation since 1981, substantial hurdles must still be overcome. Romania has not reached agreement with suppliers on several hundred million dollars in bills overdue since 1981. At present commercial creditors are unwilling to lend new money to Romania. As a result, Bucharest still must rely on the IMF and World Bank for fresh loans. A critical question for the future will be the potential impact on the domestic economy of the severe trade adjustment.

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This memorandum was prepared by [] East European Division, Office of European Analysis. It was requested by Mr. William Milam, Director, Office of Monetary Affairs, US Department of State. Comments and questions are welcome and should be directed to [], Chief, East European Division, Office of European Analysis.

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Payments Difficulties Emerge in 1981

Romania has been in serious financial difficulties for nearly two years. Despite the approval of a \$1.1 billion IMF standby credit in June 1981. Romania's financial situation deteriorated in the second half of the year. The financial strategy worked out with the IMF was to convert the uncomfortably high level of short-term debt into medium- and long-term debt and to build up Bucharest's hard currency reserves. The flaw in this strategy was that the IMF was overly optimistic about Romania's borrowing prospects. Not only were Western banks unwilling to convert short-term debt into medium- and long-term debt, but they forced Bucharest to repay a large part of obligations coming due. []

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In the last quarter of 1981, Romania's financial situation deteriorated quickly as arrears to suppliers and banks mounted, reaching \$1.1 billion by the end of the year. As a result the IMF suspended credits under the standby arrangement. Bucharest was forced to spend scarce hard currency reserves to meet bank demands for payments, and reserves fell to \$400 million by the end of the year--equivalent to one month of hard currency imports. []

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Financing Sources Fell Short in 1982

Bucharest's 1982 financing requirement totaled \$4.4 billion, with \$2.4 billion due in principal payments on medium- and long-term debt,* \$1.1 billion needed to cover arrearages overdue since

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1981, nearly \$800 million required to repay short-term debt owed to suppliers and banks, \$150 million to cover net extensions of credit to export customers, and \$125 million to increase reserves in line with an IMF target. []

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In mid 1982, Romania had projected that it could come up with nearly \$4.9 billion for the year, more than enough to cover its financing needs. Bucharest counted on:

- rescheduling of debts and arrearages owed to banks, governments, and suppliers of approximately \$3.3 billion;
- import-related credits of \$850 million; and
- IMF and World Bank credits of \$385 million and \$349 million, respectively.

Bucharest's projections of the financing available both from debt relief and from new credits were overly optimistic.

Private Rescheduling Agreement After 11 months of negotiations, Romania and nine Western banks signed an agreement on 7 December to reschedule 80 percent of both arrear's from 1981 and principal payments due in 1982; the remaining 20 percent was due in two installments in January and March 1983. According to data [] in January, Bucharest was only able to secure \$1.4 billion in debt relief from banks in 1982, about \$1 billion less than requested at the outset of rescheduling talks. The main reasons for the reduced amount were

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[redacted]

that firms balked at the Romanian request to convert their short-term loans into six-and-a-half year credits, and banks failed in their efforts to have suppliers credits included in the bank pact. [redacted]

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[redacted] a partial solution to the supplier credit problems was reached when the firms agreed to sell Romanian obligations to the banks, which in turn, rescheduled them in the same package as other bank debt. Other large supplier credits that were excluded from the agreement were to be negotiated between the Romanians and individual firms, and Bucharest reportedly agreed to establish a fund of \$50 million to pay off firms with claims of \$50,000 or less. In any case, the IMF staff reports that \$388 million in supplier arrears remained unsettled at the end of 1982. The Fund has pressed Bucharest to clear these debts as soon as possible. [redacted]

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Agreements With Other Creditors The bank rescheduling agreement was conditional on the restoration of Romania's access to IMF standby credits and on the conclusion of debt relief agreements between Romania and its other creditors. Similarly, the IMF and the Paris Club of government creditors made their agreements contingent on Romania's conclusion of agreements with the other two groups. These mutual contingencies delayed and complicated resolution of Bucharest's relations with creditors.

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[redacted]

Last June, the IMF agreed to restore Bucharest's access to the standby credit, clearing the way for Western governments to

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begin talks on debt relief. In July the Paris Club quickly agreed to reschedule 80 percent of principal and interest payments due in 1982 and arrears from 1981. Similar to the bank pact, the Paris Club agreement deferred repayments for six and one-half years, including a three-year grace period. [REDACTED]

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A key difference between the bank and government agreements is that the Paris Club agreed to reschedule only medium- and long-term debt and required that \$260 million in short-term credits be paid by 30 September. Bucharest was unable to meet these demands, but maintained that all payments would be made by the end of the year. Foreign Trade Bank President Eremia said in October that Romania had been surprised by the large volume of officially-backed short-term debt, suggesting that suppliers had insured Romanian obligations with Western governments without notifying Romania. This requirement added to the confusion over which obligations would be rescheduled, with some banks arguing that the governments would get more favorable treatment if the private banks provided relief from short-term debts. [REDACTED]

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Bucharest was slow in lining up bilateral agreements with the 15 signators to the Paris Club agreement because of its failure to pay short-term obligations guaranteed by the governments. The agreements with the United States and Canada were not signed until the first quarter of 1983 and West Germany apparently is still not in the fold. We estimate that debt relief from the Paris Club in 1982 totalled about \$400 million.

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[redacted]

Bucharest also was required to obtain debt relief from Arab central banks and CEMA creditors, who were not part of the private bank group or the Paris Club. The Romanians claim to have worked out agreements for \$340 million in debt due to the central banks of Libya, Iraq, and Iran and for the \$191 million owed to CEMA banks--the International Investment Bank and the International Bank for Economic Cooperation--but Bucharest has not specified the terms. [redacted]

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Therefore, Bucharest was able to wrap up only \$2.7 billion of the \$3.3 billion in debt relief it had projected for 1982.

Credit Problems Bucharest had somewhat more success in obtaining credits than debt relief, but IMF data show that loans fell about \$500 million short of the \$1.65 billion target agreed with the IMF early in the year. Banks generally were unwilling to lend after Bucharest requested rescheduling. Short-term trade credits totaled \$350 million--nearly all from oil exporting countries--some \$150 million less than planned. New medium- and long-term credits of \$550 million were some \$100 million less than expected. [redacted]

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On 22 December, the IMF decided to allow Bucharest to draw \$330 million, despite some loose ends, such as unsigned bilateral agreements with Paris Club members, continued refusal by some banks to accept rescheduling, and no agreement with suppliers. According to the IMF, the money was deposited in an escrow

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account at the Bank for International Settlements to pay the January and March payments to the banks called for in the 1982 rescheduling agreement. [REDACTED]

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Trade Balance Improves Romania and the IMF had initially projected that imports in 1982 were to increase slightly over the depressed 1981 level, but in the fall Bucharest was forced to cut imports by 17 percent as a result of the shortfall in sources of finance. IMF data show that Romania ran a \$1.5 billion trade surplus last year, compared with the spring forecast of \$550 million. Bucharest ran a current account surplus of about \$655 million, an improvement of \$1.5 billion compared with 1981. [REDACTED]

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Remaining Payments Gap We believe that Bucharest failed to finance \$500-600 million of its 1982 financing requirement. This gap mainly reflects arrears to suppliers for which no agreement has been reached; it also includes some unrescheduled obligations to Paris Club members.

Prospects for 1983

The 1983 financial picture looks much better than 1982. Using incomplete and inconsistent data supplied by Bucharest to the IMF and Western banks, our preliminary estimates show that Bucharest's sources of financing roughly match its requirements of \$3.3 to \$3.5 billion. This year's expected improvement stems mostly from Bucharest's crossing the hump in its debt maturity structure. Nearly two-thirds of its debt contracted through 1980 came due in 1981-82, but the payments schedule stretches out

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ROMANIA: PROJECTED SOURCES AND USES OF FINANCING IN 1983

<u>Financing requirement</u>	3,309-3,494
<u>Current account surplus</u>	-800
<u>Debt payments due</u>	3,698-3,883
Downpayments on 1982 rescheduling	391
Banks	307
Paris Club	84
Principal under original loan contracts	3,307-3,492
Debts to suppliers	564- 749
Banks	859
Paris Club	217
CEMA banks	54
International financial institutions	269
IMF	66
IBRD	103
BIS	100
Short-term debt	956
Arrears to suppliers	388
<u>Increase in reserves (IMF target)</u>	250
<u>Net credit extensions</u>	161
<u>Projected Sources</u>	3,251-3,449
<u>Debt relief</u>	1,140-1,238
Banks	601
Paris Club	201- 299
Suppliers	300
CEMA banks	38
<u>Credits</u>	995
IMF	400
IBRD	250
Suppliers credits	145
Short-term oil credits	200
<u>Rollover of short-term debt</u>	800- 900
<u>Drawdown of BIS deposit</u>	316

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considerably beginning this year. This projected improvement is tempered, however, by overdue obligations from 1982, which now have to be covered. []

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Continued Trade Adjustment Romania is holding to its strategy of painful adjustment by forcing a net flow of resources out of the domestic economy. Bucharest is projecting an increased current account surplus in 1983 resulting from another boost in the trade balance. In a letter to the IMF accompanying the review of the standby arrangement, Finance Minister Gigea pledged to meet the target of an \$800 million current account surplus even if it means sacrificing fulfillment of the growth target. []

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Bucharest expects to run a trade surplus of \$1.6 billion, an improvement of \$75 million compared with 1982. This target will not only be difficult to achieve, but perhaps risky as well, given the impact on the economy of the more modest adjustments already made. Bucharest has told the IMF that the 6 percent growth rate projected for exports will come from a 17 percent increase in sales of refined petroleum products and a 2 percent gain in nonoil exports. The modest increase projected for nonoil exports should be manageable, but the boost in oil products exports seems overly optimistic, given the soft energy market and Bucharest's own energy problems. []

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Imports are set to rise by 6 percent to \$5 billion--still far below the 1980 peak of \$8.1 billion. Bucharest plans further reductions in imports of crude oil and grain, while imports of

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machinery and equipment, ferrous and nonferrous metals are slated to increase substantially. [REDACTED]

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Financing Requirements

Bucharest owes Western creditors \$3.7 to \$3.9 billion in principal this year, including:

- nearly \$400 million in downpayments called for in 1982 rescheduling agreements with banks and the Paris Club;
- \$1.1 billion due to banks and governments under original contracts for medium-and long-term loans;
- almost \$1 billion in short-term debt;
- obligations to suppliers of \$1 billion or more, including arrears of \$388 million for which Bucharest was unable to conclude an agreement in 1982; and
- \$269 million owed to international financial institutions.

In addition, Bucharest's financing needs include an increase in reserves of \$250 million and projected net credit extensions of \$161 million. Allowing for the projected \$800 million current account surplus, we estimate a financing requirement of \$3.3 to 3.5 billion; the range arises from different estimates of the amount owed to suppliers.

Financing Sources We estimate that Bucharest will be able to cover its financing requirement this year if it can obtain the debt relief and new credits it projects, and is able to rollover nearly all of its short-term debt. The picture looks relatively bright now because debt relief negotiations appear to be

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proceeding well and Bucharest's credit needs are modest. The major uncertainty is whether Bucharest can meet its ambitious target for a large trade surplus. Another uncertainty is whether Romania can rollover its short-term debt. If creditors are spooked by unforeseen political problems in Romania or by developments elsewhere in Eastern Europe and they choose to further reduce their short-term exposure, Bucharest would have difficulty paying off short-term debts in addition to meeting its other obligations. [REDACTED]

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Status of Rescheduling Bucharest's effort to reschedule 1983 debt to the banks appears to be moving smoothly, especially compared to the 1982 negotiations. There were some doubts about whether Romania would need to reschedule this year, but at the end of 1982, Romania informed its creditors that payments due in 1983 would be suspended pending conclusion of a rescheduling agreement with the banks. In only their second negotiating session--held in early February--Romania and the nine major Western banks that led the 1982 rescheduling effort agreed on terms which are tougher for Romania. Only 70 percent of some \$900 million in principal payments to banks is to be rescheduled instead of the 80 percent in 1982. Moreover, all of the unrescheduled principal is due in the second half of this year, and some of the rescheduled amount is due next year. [REDACTED]

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[REDACTED] [REDACTED] creditors have responded favorably to the terms and the agreement probably will be signed in May or June.

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Several factors account for the rapid progress this year:

- Romanian officials were more businesslike and cooperative, both in negotiating with the banks and in meeting commitments of the 1982 agreement;
- the amount of debt to be rescheduled is less than half the amount of debt relief from private creditors in 1982;
- treatment of short-term bank debt is not an issue because most of it was either paid or rescheduled last year; and
- some of the banks most opposed to the 1982 agreement succeeded in reducing their exposure last year.

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The Paris Club is off to a slower start because of Bucharest's lagging efforts in signing bilateral accords with Western governments to conclude the 1982 Paris Club agreement. The Paris Club apparently will discuss 1983 rescheduling on May 19. In December Bucharest requested that this year's pact provide relief from 75 percent of the principal and interest due to Paris Club members. This would be worth about \$300 million; rescheduling of principal alone would provide roughly \$100 million less in debt relief.

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Credits Romania expects to receive \$1 billion in new credits this year, two-thirds of which are to come from the IMF and World Bank. The IMF approved Romania's performance in the December 1982 and March 1983 reviews of the three year standby arrangement and has continued to disburse funds. The IMF

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continues to watch Romania's situation closely and further reviews will take place in July and November. The prospects now appear good that Bucharest will receive the \$400 million it has requested this year. A World Bank team visited Romania early this year to consider projects for financing. The Romanians also hope to obtain \$350 million in loans to finance imports of oil and other raw materials. While Romania's credit rating is still poor, this amount of credits is modest enough that it should be obtainable.

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In sum, we estimate that Romania's financing sources in 1983 total \$3.2 to 3.4 billion:

- \$1.1 to 1.2 billion in debt relief, including some \$300 million to cover 1982 arrearages to suppliers;
- \$1 billion in new credits;
- rollovers of \$800-900 million in short-term debt; and
- drawdown of \$16 million from the BIS escrow account.

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**Distribution List for Romania's Financial Situation and
Outlook for 1983**

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